



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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2002 OCT 25 P 4:11

October 25, 2002

MEMORANDUM

TO: The Commission

FROM: Mai Dinh, Acting Assistant General Counsel *MD*
Anne A. Weissenborn, Senior Attorney *AAW*

SUBJECT: Supplementary Documents related to AO 2002-12

On October 21, 2002 this Office circulated for the Commission's information a letter dated October 18, 2002 from counsel for the requestor in AOR 2002-12 agreeing to an extension of time for the Commission to issue an opinion. Attached to the original letter was a U.S. Securities and Exchange Commission Form 144 (Notice of Proposed Sale of Securities) dated September 11, 2002 and an SEC Form 4 (Statement of Changes in Beneficial Ownership) dated October 15, 2002. These documents are being circulated, together with the e-mail from this Office suggesting an extension of time, as attachments to this memorandum.

Earlier, this Office distributed to the Commission two letters from counsel dated July 24, 2002 and September 3, 2002, along with materials submitted in response to questions posed by this Office. These responses revealed, *inter alia*, the steadily declining ownership interest of Cobalt Corporation/BCBS in American Medical Security Group, Inc, the parent company of American Medical Security, Inc., an interest which reached 12.3% as per the documents provided on October 18, 2002.

Also attached for the Commission's information are portions of the 2000 Annual Report of Cobalt Corporation/United Wisconsin Service, Inc. and of the 2000 Annual Report of American Medical Security Group, Inc. These reports were submitted in February, 2002 as attachments to the original advisory opinion request. The attached portions of the two annual reports consist of consolidated balance sheets for the period addressed in the reports and, in particular, information related to stock issues and holdings. The full reports are available in this Office. Because the portions of the financial information in these reports relevant to AO 2002-12 have been superseded by more recently supplied information, this particular information is being circulated as background only.

Attachments

SEC Form 144 dated September 11, 2002
SEC Form 4 dated October 15, 2002
E-mail from OGC dated October 18, 2002
Financial information from annual reports for 2000



Anne Weissenborn on 10/18/2002 09:49:13 AM

To: mwittenw@gklaw.com
cc:

Subject: Advisory Opinion Request

To: Mike B. Wittenwyler:

I am writing to confirm our telephone conversations over the last couple of weeks in which you answered some questions that arise from your letter of September 3, 2002, and also informed us that Blue Cross Blue Shield United of Wisconsin has recently sold additional shares of AMSG common stock. You expressed oral agreement with a suggestion on my part that there be an extension of time for the Commission to issue an advisory opinion regarding the disaffiliation of BCBS PAC and AMS PAC, in light of the ongoing changes in stock ownership and also in light of the Commission's presently heavy workload. You stated that you would submit written agreement to such an extension after you received some additional information and paperwork from your client.

November 4, 2002 is the present deadline for issuance of an advisory opinion to your client. This Office has determined that December 13, 2002 would be a feasible revised deadline for the Commission to issue an opinion. If this latter date is acceptable to you, please send us an e-mail or letter to this effect as soon as possible.

We would also appreciate your including in your letters brief responses to my telephoned questions about whether preferred stock has been issued and about Mr. Hefty's exercise of his stock options. I know you responded orally, but we need the answers in writing. Just a couple of sentences will be fine.

Thank you very much,

Anne Weissenborn
Senior Attorney

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 144

NOTICE OF PROPOSED SALE OF SECURITIES
PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933

ATTENTION: Transmittal for filing & copies of this form concurrently with either / facing an order with a broker to execute sale or executing a sale directly with a market maker.

FILER'S NAME (If issuer, name of issuer; if not, name of broker)		FILER'S ADDRESS (If issuer, name of issuer; if not, name of broker)		FILER'S CITY		FILER'S STATE		FILER'S ZIP CODE		FILER'S PHONE NO.		FILER'S FAX NO.		FILER'S E-MAIL ADDRESS	
American Medical Security Group, Inc.		1000 Axis Boulevard		Greenville		SC		29605		864-691-1111		864-691-1111		AMSG@AMSG.COM	
FILER'S BUSINESS ADDRESS (If issuer, name of issuer; if not, name of broker)		FILER'S CITY		FILER'S STATE		FILER'S ZIP CODE		FILER'S PHONE NO.		FILER'S FAX NO.		FILER'S E-MAIL ADDRESS		FILER'S FILING OFFICE ADDRESS (If issuer, name of issuer; if not, name of broker)	
Blue Cross of Blue Shield United of Wisconsin		Blue Cross of Blue Shield United of Wisconsin		Greenville		SC		29605		864-691-1111		864-691-1111		AMSG@AMSG.COM	

INSTRUCTION: The person filing this notice should contact the issuer to obtain the I.R.N. Identification Number and the S.E.C. File Number.

1. Name of Issuer	2. Title and Address of Each Holder Through Whom the Securities are Being Offered or Sold (If issuer, name of issuer; if not, name of broker)	3. SEC REGISTRATION NO.	4. REGISTRATION STATE	5. REGISTRATION DATE	6. REGISTRATION TYPE	7. REGISTRATION STATUS	8. REGISTRATION EXPIRATION DATE	9. REGISTRATION FEE	10. REGISTRATION FEE TYPE	11. REGISTRATION FEE AMOUNT	12. REGISTRATION FEE PERCENTAGE	13. REGISTRATION FEE CALCULATION	14. REGISTRATION FEE PAYMENT DATE	15. REGISTRATION FEE PAYMENT METHOD	16. REGISTRATION FEE PAYMENT REFERENCE	17. REGISTRATION FEE PAYMENT CONTACT	18. REGISTRATION FEE PAYMENT ADDRESS	19. REGISTRATION FEE PAYMENT CITY	20. REGISTRATION FEE PAYMENT STATE	21. REGISTRATION FEE PAYMENT ZIP CODE	22. REGISTRATION FEE PAYMENT PHONE NO.	23. REGISTRATION FEE PAYMENT FAX NO.	24. REGISTRATION FEE PAYMENT E-MAIL ADDRESS	25. REGISTRATION FEE PAYMENT OTHER INFORMATION
Common Stock	Saleman Smith Barney 390 Greenwich Street New York, NY 10012	405,550	6,135,694	12,889,898	On or after September 11																			

INSTRUCTIONS:

1. (a) Name of issuer
- (b) Name of issuer's S.E.C. Identification Number
- (c) Name of issuer's S.E.C. File Number, if any
- (d) Name of issuer's address, including zip code
- (e) Issuer's telephone number, including area code
- (f) Name of person to whom payment for securities are to be made
- (g) Name of issuer's S.E.C. Identification Number, if such person is an issuer
- (h) Name of issuer's S.E.C. File Number, if such person is an issuer
- (i) Name of issuer's address, including zip code
- (j) Name of issuer's telephone number, including area code

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1147 (10-001)

001.92956811

TABLE I — SECURITIES TO BE SOLD

Furnish the following information with respect to the acquisition of the securities to be sold and with respect to the payment of all or any part of the purchase price or other consideration therefor:

Table of to 1993	Date of Acquired	Name of Issuer/Transaction	Form of Payment (If not, the date when received)	Amount of Security Acquired	Date of Payment	Name of Payee
Common Stock	1983	Assoc/Share Exchange	American Medical Security Group, Inc.	All securities owned by undersigned, currently 1,408,035.	1/25/83	Contribution of shares to subsidiary

INSTRUCTIONS: 1. If the securities were purchased and full payment therefor was not made in cash at the time of purchase, explain on the table or in a note thereon the nature of the consideration given. If the consideration consisted of any note or other obligation, or if payment was made in installments, describe the arrangement and state when the note or other obligation was discharged in full or the last installment paid.

2. If within one year after the acquisition of the securities the person for whose account they are to be sold had any short position, put or other option to dispose of securities referred to in paragraph (a)(2) of Rule 144, furnish full information with respect thereto.

TABLE II — SECURITIES SOLD DURING THE PAST 3 MONTHS

Furnish the following information as to all securities of the issuer sold during the past 3 months by the person for whose account the securities are to be sold.

Name and Address of Seller	Title of Securities Sold	Amount Sold	Amount of Securities Sold	Date of Sale

ATTENTION:

INSTRUCTIONS:

See the definition of "person" in paragraph (a) of Rule 144. Information is to be given not only as to the person for whose account the securities are to be sold but also as to all other persons involved in that definition. In addition, information shall be given as to sales by all persons whose sales are required by paragraph (c) of Rule 144 to be aggregated with sales for the account of the person filing this notice.

ATTENTION:

The person for whose account the securities to which this notice relates are to be sold hereby represents by signing this notice that he does not know any material adverse information in regard to the current and prospective operations of the issuer of the securities to be sold which has not been publicly disclosed.

September 11, 2002

DATE OF NOTICE

The notice shall be signed by the person for whose account the securities are to be sold. At least one copy of the notice shall be manually signed.

Any copies not manually signed shall bear typed or printed signatures.

ATTENTION: Intentional misstatements or omission of facts constitute Federal Criminal Violations (See 18 U.S.C. 1001)

SEC 1147 (8-01)

001.128580.1.1

OMB APPROVAL

OMB Number 3235-0287

Expires: January 31, 2005

Estimated average burden
hours per response 0.5**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 4**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934,
Section 17(a) of the Public Utility Holding Company Act of 1935 or
Section 30(h) of the Investment Company Act of 1940

☐ Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. See Instruction 1(b).

1. Name and Address of Reporting Person***BLUE CROSS & BLUE SHIELD UNITED OF WISCONSIN (1)**

(Last) (First) (Middle)

401 WEST MICHIGAN STREET

(Street)

MILWAUKEE, WI 53203

(City) (State) (Zip)

2. Issuer Name and Ticker or Trading Symbol**AMERICAN MEDICAL SECURITY GROUP, INC. (AMZ)****3. IRS Identification Number of Reporting Person, if an Entity (Voluntary)****4. Statement for Month/Day/Year**

October 15, 2002

5. If Amendment, Date of Original (Month/Day/Year)**6. Relationship of Reporting Person(s) to Issuer**

(Check all applicable)

☐ Director ☒ 10% Owner☐ Officer (give title below) ☐ Other (specify below)

Individual or Joint/Group Filing (Check applicable line)

☐ Form filed by one Reporting Person

☒ Form filed by more than one Reporting Person

Table I -- Non-Derivative Securities Acquired, Disposed of,
or Beneficially Owned

1. Title of Security (Instr. 3)	2. Transaction Date (Month/ Day/ Year)	2A. Deemed Execution Date, if any (Month/ Day/ Year)	3. Transaction Code (Instr. 8) Code V	4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Follow- ing Reported Transaction(s) (Instr. 3 and 4)	6. Owner- ship Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
				Amount	(A) or (D)	Price			
Common Stock	10/15/02		S	10,000	D	\$14.00	See below	D	
Common Stock	10/15/02		S	3,200	D	\$16.10	1,985,875	D	

(1) As a result of the conversion of Blue Cross & Blue Shield United of Wisconsin ("BCBSUW") from a Wisconsin service insurance corporation to a Wisconsin stock insurance corporation, Cobalt Corporation became the owner of 100% of the issued and outstanding common stock of BCBSUW and Wisconsin United for Health Foundation, Inc. ("Foundation") became the owner of 77.5% of the issued and outstanding common stock of Cobalt Corporation. Consequently, Cobalt Corporation became a beneficial owner and the Foundation became an indirect beneficial owner of the Common Stock owned by BCBSUW.

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

* If the Form is filed by more than one Reporting Person, see Instruction 4(b)(v).

Persons who respond to the collection of information contained in this form are not required to respond (Over) unless the form displays a currently valid OMB SEC 1474 (9-02) control number.

Table II -- Derivative Securities Acquired, Disposed of, or Beneficially Owned
(e.g., puts, calls, warrants, options, convertible securities)

Explanation of Responses:
BLUE CROSS & BLUE SHIELD UNITED OF WISCONSIN

10/16/02

Date _____

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, see Instruction 6 for procedure.

JOINT FILER INFORMATION

Name: Cobalt Corporation

Address: 401 West Michigan Avenue
Milwaukee, Wisconsin 53203

Designated Filer: Blue Cross & Blue Shield United of
Wisconsin

Issuer and Ticker Symbol: American Medical Security Group, Inc.
(AMZ)

Date of Event Requiring Statement: October 15, 2002

Signature: COBALT CORPORATION

By: /s/ Gail L. Hanson

Gail L. Hanson
Senior Vice President

Name: Wisconsin United for Health
Foundation, Inc.

Address: 10 East Doty Street, Suite 600
Madison, Wisconsin 53701

Designated Filer: Blue Cross & Blue Shield United of
Wisconsin

Issuer and Ticker Symbol: American Medical Security Group, Inc.
(AMZ)

Date of Event Requiring Statement: October 15, 2002

Signature: WISCONSIN UNITED FOR HEALTH
FOUNDATION, INC.

By: /s/ David Meissner

David Meissner
Vice President

American Medical Security Group, Inc.
2000 Annual Report



“2000 was a year of building and focusing for AMS”

Samuel V. Miller
Chairman and Chief Executive Officer

American Medical Security Group, Inc.

Consolidated Balance Sheets

	December 31,	
	2000	1999
	<i>(In thousands)</i>	
Assets:		
Investments:		
Securities available for sale, at fair value:		
Fixed maturities	\$ 262,428	\$ 270,800
Equity securities – preferred	2,368	2,198
Fixed maturity securities held to maturity, at amortized cost	4,320	3,275
Trading securities, at fair value	260	-
Total investments	<u>269,376</u>	<u>276,273</u>
Cash and cash equivalents	15,606	17,266
Other assets:		
Property and equipment, net	32,451	32,624
Goodwill and other intangibles, net	107,562	111,347
Other assets	46,928	65,584
Total other assets	<u>186,941</u>	<u>209,555</u>
Total assets	<u>\$ 471,923</u>	<u>\$ 503,094</u>
Liabilities and Shareholders' Equity:		
Liabilities:		
Medical and other benefits payable	\$ 145,310	\$ 169,117
Advance premiums	17,568	17,277
Payables and accrued expenses	25,902	25,044
Notes payable	41,258	42,523
Other liabilities	20,708	28,853
Total liabilities	<u>250,746</u>	<u>282,814</u>
Redeemable preferred stock – Series A adjustable rate nonconvertible, \$1,000 stated value, 25,000 shares authorized	-	-
Shareholders' equity:		
Preferred stock (no par value, 475,000 shares authorized)	-	-
Common stock (no par value, \$1 stated value, 50,000,000 shares authorized, 16,654,315 issued and 14,270,945 outstanding at December 31, 2000, 16,653,646 issued and 15,532,146 outstanding at December 31, 1999)	16,654	16,654
Paid-in capital	187,956	187,952
Retained earnings	36,295	33,626
Accumulated other comprehensive loss (net of tax benefit of \$2,126,000 in 2000 and \$5,634,000 in 1999)	(3,948)	(10,464)
Treasury stock (2,383,370 shares at December 31, 2000 and 1,121,500 shares at December 31, 1999, at cost)	(15,780)	(7,488)
Total shareholders' equity	<u>221,177</u>	<u>220,280</u>
Total liabilities and shareholders' equity	<u>\$ 471,923</u>	<u>\$ 503,094</u>

See accompanying notes to Consolidated Financial Statements

American Medical Security Group, Inc.

Consolidated Statements of Operations

	Year ended December 31,		
	2000	1999	1998
	<i>(In thousands, except per share data)</i>		
Revenues:			
Insurance premiums	\$ 951,071	\$1,056,107	\$ 914,017
Net investment income	18,682	18,912	24,220
Other revenue	20,112	22,361	22,632
Total revenues	<u>989,865</u>	<u>1,097,380</u>	<u>960,869</u>
Expenses:			
Medical and other benefits	724,613	860,473	691,767
Selling, general and administrative	251,767	268,059	242,073
Interest	3,584	3,564	7,691
Amortization of goodwill and other intangibles	3,785	4,273	8,781
Write-off of intangible assets and related charges	-	-	15,453
Total expenses	<u>983,749</u>	<u>1,136,369</u>	<u>965,765</u>
Income (loss) from continuing operations, before income taxes	6,116	(38,989)	(4,896)
Income tax expense (benefit)	<u>3,447</u>	<u>(13,043)</u>	<u>(1,868)</u>
Income (loss) from continuing operations	2,669	(25,946)	(3,028)
Income from discontinued operations, less applicable income taxes	-	-	<u>10,003</u>
Net income (loss)	<u>\$ 2,669</u>	<u>\$ (25,946)</u>	<u>\$ 6,975</u>
Earnings (loss) per common share – basic			
Continuing operations	\$ 0.18	\$ (1.58)	\$ (0.18)
Discontinued operations	-	-	0.60
Net income (loss) per common share – basic	<u>\$ 0.18</u>	<u>\$ (1.58)</u>	<u>\$ 0.42</u>
Earnings (loss) per common share – diluted			
Continuing operations	\$ 0.18	\$ (1.58)	\$ (0.18)
Discontinued operations	-	-	0.60
Net income (loss) per common share – diluted	<u>\$ 0.18</u>	<u>\$ (1.58)</u>	<u>\$ 0.42</u>

See accompanying notes to Consolidated Financial Statements

American Medical Security Group, Inc.

Consolidated Statements of Cash Flows

	Year ended December 31,		
	2000	1999	1998
	<i>(In thousands)</i>		
Operating Activities:			
Income (loss) from continuing operations	\$ 2,669	\$ (25,946)	\$ (3,028)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used in) operating activities:			
Depreciation and amortization	9,762	11,038	15,343
Write-off of intangible assets	-	-	12,833
Net realized investment losses (gains)	325	854	(3,670)
Net change in trading securities	(260)	-	-
Deferred income tax expense (benefit)	6,029	(7,112)	(8,256)
Changes in operating accounts:			
Other assets	9,119	(12,945)	(4,869)
Medical and other benefits payable	(23,807)	55,984	(14,911)
Advance premiums	291	(880)	(2,004)
Payables and accrued expenses	858	1,605	(6,129)
Other liabilities	(8,145)	3,830	10,982
Net cash provided by (used in) operating activities	(3,159)	26,428	(3,709)
Investing Activities:			
Acquisition of subsidiaries (net of cash and cash equivalents acquired in 1998 of \$2,773,000)	-	-	2,623
Purchases of available for sale securities	(14,512)	(190,834)	(347,931)
Proceeds from sale of available for sale securities	25,460	172,086	300,416
Proceeds from maturity of available for sale securities	4,045	20,805	20,225
Purchases of held to maturity securities	-	(686)	(540)
Proceeds from maturity of held to maturity securities	630	770	1,100
Purchases of property and equipment	(4,584)	(2,976)	(3,326)
Proceeds from sale of property and equipment	13	1,049	254
Net cash provided by (used in) investing activities	11,052	214	(27,179)
Financing Activities:			
Cash dividends paid	-	-	(5,956)
Issuance of common stock	4	5	2,356
Purchase of treasury stock	(8,292)	(7,488)	-
Proceeds from notes payable borrowings	39,158	5,000	45,158
Repayment of notes payable	(40,423)	(17,541)	(46,944)
Net cash used in financing activities	(9,553)	(20,024)	(5,386)
Net cash provided by discontinued operations	-	-	1,631
Cash and cash equivalents:			
Net increase (decrease) during year	(1,660)	6,618	(34,643)
Balance at beginning of year	17,266	10,648	45,291
Balance at end of year	\$ 15,606	\$ 17,266	\$ 10,648

See accompanying notes to Consolidated Financial Statements

American Medical Security Group, Inc.

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

	Common Stock		Paid-In	Retained	Accumulated Other Comprehensive	Treasury	Total
	Shares	Amount	Capital	Earnings	Income (Loss)	Stock	
<i>(In thousands, except share data)</i>							
Balance at January 1, 1998	16,509,578	\$ 16,510	\$186,768	\$117,331	\$ 5,768	\$ -	\$326,377
Comprehensive income:							
Net income				6,975			6,975
Change in net unrealized gain on securities, net of taxes of \$642,000					(4,613)		(4,613)
Comprehensive income							<u>2,362</u>
Cash dividends paid on common stock (\$0.36 per share)				(5,956)			(5,956)
Issuance of common stock	143,601	143	2,213				2,356
Distribution of Newco/UWS to Shareholders				(58,778)	90		(58,688)
Balance at December 31, 1998	16,653,179	16,653	188,981	59,572	1,245	-	266,451
Comprehensive loss:							
Net loss				(25,946)			(25,946)
Change in net unrealized gain on securities, net of taxes of \$6,304,000					(11,709)		(11,709)
Comprehensive loss							<u>(37,655)</u>
Issuance of common stock	467	1	4				5
Stock option forfeiture			(1,033)				(1,033)
Purchase of treasury stock (1,121,500 shares, at cost)						(7,488)	(7,488)
Balance at December 31, 1999	16,653,646	16,654	187,952	33,626	(10,464)	(7,488)	220,280
Comprehensive income:							
Net income				2,669			2,669
Change in net unrealized loss on securities, net of taxes of \$3,508,000					6,516		6,516
Comprehensive income							<u>9,185</u>
Issuance of common stock	669		4				4
Purchase of treasury stock (1,261,870 shares, at cost)						(8,292)	(8,292)
Balance at December 31, 2000	16,654,315	\$ 16,654	\$187,956	\$ 36,295	\$ (3,948)	\$ (15,780)	\$221,177

See accompanying notes to Consolidated Financial Statements

American Medical Security Group, Inc.

Notes to Consolidated Financial Statements

1. Organization and Significant Accounting Policies

Organization

American Medical Security Group, Inc., together with its subsidiary companies ("AMSG" or the "Company"), is a provider of health care benefits and insurance products for individuals and small employer groups. The Company's principal product offering is health insurance for small employer groups and health insurance for individuals and families ("MedOne"). The Company also offers life, dental, prescription drug, disability and accidental death insurance, and provides self-funded benefit administration. The Company's products are actively marketed in 32 states and the District of Columbia through independent agents. Approximately 70 Company sales managers located in sales offices throughout the United States support the independent agents. The Company's products generally provide discounts to insureds that utilize preferred provider organizations ("PPOs"). AMSG owns a preferred provider network and also contracts with several other networks to ensure cost-effective health care choices to its customers.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and all of its majority-owned subsidiaries. Significant intercompany accounts and transactions have been eliminated. The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include operating cash and short-term investments with original maturities of three months or less. These amounts are recorded at cost, which approximates market value.

Investments

The Company's investments are classified in three categories. Investments that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity securities and are reported at amortized cost. Assets which are invested for the purpose of supporting the Company's nonqualified executive retirement plan are classified as trading securities and reported at fair value, with unrealized gains and losses included in earnings as net investment income. All other investments are classified as available-for-sale securities and are reported at fair value based on quoted market prices, with unrealized gains and losses excluded from earnings and reported as a separate component of shareholders' equity as accumulated other comprehensive income or loss, net of income tax effects. Realized gains and losses from the sale of available-for-sale debt and equity securities are calculated using the specific identification method.

Fair Value of Financial Instruments

The fair values of investments are reported in Note 3. The fair values of all other financial instruments approximate their December 31, 2000 and 1999 carrying values.

Goodwill and Other Intangibles

Goodwill represents the excess of cost over the fair market value of net assets acquired. Goodwill and other intangible assets are being amortized on a straight-line basis over a period of 40 years or less. Accumulated amortization was \$16,461,000 and \$12,676,000 at December 31, 2000 and 1999, respectively.

The Company periodically evaluates whether events and circumstances have occurred that may affect the estimated useful life or the recoverability of the remaining balance of its intangibles. A study conducted during 1998 determined that the Company's sales distribution system intangible assets were impaired. The sales distribution system was acquired on December 3, 1996 in conjunction with the purchase of the Company's small group business. Since the acquisition, the Company has largely eliminated its commission-based sales distribution system, replacing it with salaried sales offices. This resulted in an after-tax charge to 1998 operations of \$9,251,000 or \$0.56 per share, including \$7,683,000 of intangible distribution system assets' and \$1,568,000 of related costs. The Company's management believes that no impairment of goodwill or other intangible assets exists at December 31, 2000.

Revenue Recognition

Premiums for health and life policies are recognized ratably over the period that insurance coverage is provided. Other revenue, including administrative fee income from claim processing and other administrative services, is recognized in the period the service is provided.

Medical and Other Benefits

The liabilities for medical and other benefits are determined using statistical analyses and represent estimates of the ultimate net cost of all reported and unreported claims that are unpaid at year end. The Company's year-end claim liabilities are substantially satisfied through claim payments in the subsequent year. Management believes that the liabilities for insurance claims are adequate. The liability for unpaid claims of \$139,457,000 at December 31, 1999, developed redundant in the subsequent year by \$3,397,000. The liability for unpaid claims of \$101,721,000 at December 31, 1998, developed deficient by \$10,398,000 in the subsequent year. The liability for unpaid claims of \$123,907,000 at December 31, 1997, developed deficient by \$1,228,000 in the subsequent year. The estimates are reviewed periodically and, as adjustments to the liabilities become necessary, the adjustments are reflected in current operations.

Premium Deficiency Reserves

The Company recognizes premium deficiency reserves on an existing group of insurance contracts when the sum of expected future claim costs, claim adjustment expenses and related maintenance expenses exceeds the expected future premium revenue and investment income. Insurance contracts are grouped as relating to highly regulated markets or all other markets consistent with the Company's manner of acquiring, servicing and measuring the profitability of its business. Highly regulated markets are identified based on significant rating restrictions, states' general legislative and regulatory environments, and the Company's ability to effectively underwrite risk. The Company continues to evaluate assumptions and updates the premium deficiency reserves as necessary.

During 1999, the Company established a premium deficiency reserve of \$19,200,000 for its highly regulated markets. At December 31, 2000 and 1999, the Company had remaining recorded premium deficiency reserves totaling \$1,142,000 and \$16,700,000, respectively, which are included in medical and other benefits payable in the accompanying balance sheets. No premium deficiency reserves were recorded prior to 1999.

Reinsurance

Reinsurance premiums, commissions and expense reimbursements on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts. Premiums and benefits ceded to other companies have been reported as a reduction of premium revenue and benefits. Reinsurance receivables and prepaid reinsurance premium amounts are reported as assets.

The Company limits the maximum net loss that can arise from certain lines of business by reinsuring (ceding) a portion of these risks with other insurance organizations (reinsurers) on an excess of loss or quota share basis. The Company's retention limit per covered life is \$500,000 per policy year for medical claims and \$50,000 for life claims. The Company is contingently liable on reinsurance ceded in the event that the reinsurers do not meet their contractual obligations.

A summary of reinsurance assumed and ceded is as follows:

	Year ended December 31,		
	2000	1999	1998
	(In thousands)		
Reinsurance assumed:			
Insurance premiums	\$ 8,725	\$ 58,924	\$ 45,056
Medical and other benefits	9,921	52,137	37,593
Reinsurance ceded:			
Insurance premiums	\$ 2,523	\$ 4,916	\$ 16,936
Medical and other benefits	3,250	7,897	14,099

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful lives, which are 20 to 30 years for land improvements, 10 to 40 years for buildings and building improvements, three to five years for computer equipment and software and three to 10 years for furniture and other equipment.

Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial statement purposes and the amounts used for income tax purposes. A valuation allowance is recognized when, based on available evidence, it is more likely than not that the deferred tax asset may not be realized.

Related Parties

The Company has deferred compensation payable to employees of \$3,388,000 and \$3,597,000 at December 31, 2000 and 1999, respectively.

Earnings Per Common Share

A reconciliation of the numerator and denominator of the basic and diluted earnings per common share ("EPS") is as follows:

	Year ended December 31,		
	2000	1999	1998
	<i>(In thousands, except share and per share data)</i>		
Numerator:			
Income (loss) from continuing operations	\$ 2,669	\$ (25,946)	\$ (3,028)
Denominator:			
Denominator for basic EPS – weighted average shares	14,898,652	16,470,096	16,558,887
Effect of dilutive securities – employee stock options	150,651	-	-
Denominator for diluted EPS	15,049,303	16,470,096	16,558,887
Income (loss) from continuing operations per common share:			
Basic	\$ 0.18	\$ (1.58)	\$ (0.18)
Diluted	\$ 0.18	\$ (1.58)	\$ (0.18)

Options to purchase 3,460,130 shares of common stock were outstanding at the end of 2000 and all but 1,429,960 were excluded from the computation of diluted earnings per share because the option's exercise price was greater than the average market price of common shares and, therefore, the effect would be antidilutive. There was no effect of dilutive securities for 1999 and 1998 because employee stock options were antidilutive during such periods.

Comprehensive Income (Loss)

Comprehensive income (loss) is defined as net income (loss) plus or minus other comprehensive income (loss). For the Company, under existing accounting standards, other comprehensive income (loss) includes unrealized gains and losses, net of income tax effects, on certain investments in debt and equity securities. Comprehensive income (loss) is reported by the Company in the consolidated statements of changes in shareholders' equity and comprehensive income (loss).

2. Distribution of Newco/UWS to Shareholders

On May 27, 1998, the Board of Directors of the Company, then known as United Wisconsin Services, Inc., ("UWS") approved a plan to spin off its managed care companies and specialty management business to its shareholders (the "Distribution"). In connection with the spin-off, the Company changed its name to "American Medical Security Group, Inc." On September 25, 1998, the Distribution date, shareholders of AMSG received one share of common stock of a newly formed company, Newco/UWS, Inc. ("Newco/UWS"), for every share of AMSG owned as of September 11, 1998, the record date. AMSG obtained a private ruling from the Internal Revenue Service to the effect that the spin-off qualified as tax free to AMSG, Newco/UWS and AMSG shareholders.

The net assets of Newco/UWS consisted of assets and liabilities of the managed care and specialty management business along with \$70,000,000 in debt that was assumed by Newco/UWS in conjunction with the Distribution. Newco/UWS was renamed "United Wisconsin Services, Inc." The operations of Newco/UWS, along with direct costs of approximately \$4,900,000 associated with the spin-off, are reflected in discontinued operations. Discontinued operations reported total revenues of \$488,033,000 for 1998. Interest expense on the \$70,000,000 debt assumed by Newco/UWS is reflected in continuing operations only through September 11, 1998.

3. Investments

Net investment income from continuing operations includes the following:

	Year ended December 31,		
	2000	1999	1998
	(In thousands)		
Interest on fixed maturities	\$ 17,867	\$ 18,731	\$ 18,437
Dividends on equity securities	148	134	716
Realized gains	111	1,351	5,078
Realized losses	(436)	(2,205)	(1,408)
Unrealized loss on trading securities	(21)	-	-
Interest on cash equivalents and other investment income	1,629	1,581	2,112
Gross investment income	19,298	19,592	24,935
Investment expenses	(616)	(680)	(715)
Net investment income	\$ 18,682	\$ 18,912	\$ 24,220

Unrealized gains (losses) are computed as the difference between estimated fair value and amortized cost for fixed maturities and equity securities classified as available for sale. A summary of the net change in unrealized gains (losses), which is included in accumulated other comprehensive income (loss), is as follows:

	Year ended December 31,		
	2000	1999	1998
	(In thousands)		
Fixed maturities	\$ 9,854	\$ (17,753)	\$ (1,849)
Equity securities	170	(260)	(105)
Discontinued operations, net of deferred income taxes	-	-	(3,211)
Net change in unrealized gains (losses)	\$ 10,024	\$ (18,013)	\$ (5,165)

Changes in accumulated other comprehensive income (loss) related to changes in unrealized gains and losses on securities are as follows:

	Year ended December 31,		
	2000	1999	1998
	<i>(In thousands)</i>		
Change in net unrealized gain (loss) on securities, net of taxes	\$ 6,727	\$ (12,264)	\$ 1,074
Less: reclassification adjustment for gains (losses) included in net income (loss), net of tax benefit of \$114,000 and \$299,000 in 2000 and 1999, respectively and tax expense of \$1,284,000 in 1998	(211)	(555)	2,386
Change in net unrealized gain (loss) from continuing operations, net of taxes	6,516	(11,709)	(1,312)
Change in net unrealized gain from discontinued operations, net of taxes	-	-	(3,211)
Change in net unrealized gain (loss) on securities, net of taxes	\$ 6,516	\$ (11,709)	\$ (4,523)

The amortized cost and estimated fair values of investments are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	<i>(In thousands)</i>			
At December 31, 2000:				
Available for sale:				
Fixed maturities:				
U.S. Treasury securities	\$ 51,657	\$ 160	\$ (340)	\$ 51,477
Corporate debt securities	145,817	213	(5,142)	140,888
Foreign government securities	15,614	82	(356)	15,340
Government agency mortgage-backed securities	37,718	45	(513)	37,250
Municipal securities	17,556	6	(89)	17,473
	268,362	506	(6,440)	262,428
Equity securities – preferred	2,508	-	(140)	2,368
Held to maturity:				
U.S. Treasury securities	4,320	10	(16)	4,314
	\$ 275,190	\$ 516	\$ (6,596)	\$ 269,110

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	<i>(In thousands)</i>			
At December 31, 1999:				
Available for sale:				
Fixed maturities:				
U.S. Treasury securities	\$ 54,150	\$ -	\$ (3,488)	\$ 50,662
Corporate debt securities	152,312	90	(9,067)	143,335
Foreign government securities	16,638	-	(686)	15,952
Government agency mortgage-backed securities	44,102	12	(1,914)	42,200
Municipal securities	19,386	-	(735)	18,651
	286,588	102	(15,890)	270,800
Equity securities – preferred	2,508	-	(310)	2,198
Held to maturity:				
U.S. Treasury securities	3,275	3	(54)	3,224
	\$ 292,371	\$ 105	\$ (16,254)	\$ 276,222

The amortized cost and estimated fair values of debt securities at December 31, 2000 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
	<i>(In thousands)</i>			
Due in one year or less	\$ 14,399	\$ 14,060	\$ 300	\$ 300
Due after one through five years	114,655	112,416	2,704	2,699
Due after five through ten years	64,216	62,884	1,316	1,315
Due after ten years	37,374	35,818	-	-
	230,644	225,178	4,320	4,314
Government agency mortgage-backed securities	37,718	37,250	-	-
	<u>\$ 268,362</u>	<u>\$ 262,428</u>	<u>\$ 4,320</u>	<u>\$ 4,314</u>

At December 31, 2000, the insurance subsidiaries had fixed securities and cash equivalents on deposit with various state insurance departments with carrying values of approximately \$4,520,000.

4. Property and Equipment

Property and equipment are stated at cost and are summarized as follows:

	December 31,	
	2000	1999
	<i>(In thousands)</i>	
Land and land improvements	\$ 3,890	\$ 3,882
Building and building improvements	24,301	24,175
Computer equipment and software	13,024	9,668
Furniture and other equipment	13,495	13,476
	54,710	51,201
Less accumulated depreciation	(22,259)	(18,577)
	<u>\$ 32,451</u>	<u>\$ 32,624</u>

The Company recognized depreciation expense on property and equipment of \$4,656,000, \$4,544,000, and \$5,450,000 in 2000, 1999 and 1998, respectively.

7. Commitments and Contingencies

On August 26, 1999, a \$6.9 million verdict was entered against the Company in a lawsuit which principally alleged breach of contract involving the timing of claims payments. On April 17, 2000, the Company filed its notice of appeal of this decision with a Federal Appeals Court. Management expects the verdict to be reversed or substantially reduced following appeal. As a result, the Company's accrual related to this case is not material.

On February 7, 2000, a \$5.4 million verdict was entered against the Company in a lawsuit which alleged breach of contract involving commission amounts due to a former agent. On April 18, 2000, the Company filed a notice of appeal with an Ohio Appeals Court requesting reversal of the decision. The Appeals Court heard oral arguments on October 5, 2000, and the parties are awaiting a decision. Management expects the verdict to be reversed or substantially reduced following appeal. As a result, the Company's accrual related to this case is not material.

The Company is involved in various legal and regulatory actions occurring in the normal course of its business. In the opinion of management, adequate provision has been made for losses that may result from the above-mentioned and other legal and regulatory actions; accordingly, the outcome of these matters is not expected to have a material adverse effect on the consolidated financial statements.

8. Shareholders' Equity

Statutory Financial Information

State insurance laws and regulations prescribe accounting practices for determining statutory net income and equity for insurance companies. These regulations require, among other matters, the filing of financial statements prepared in accordance with statutory accounting practices prescribed or permitted for insurance companies. The combined statutory surplus of the Company's insurance subsidiaries, United Wisconsin Life Insurance Company and American Medical Security Insurance Company of Georgia, at December 31, 2000 and 1999, was \$153,912,000 and \$155,937,000, respectively.

State insurance regulations also require the maintenance of a minimum compulsory surplus based on a percentage of premiums written. At December 31, 2000, the Company's insurance subsidiaries were in compliance with these compulsory regulatory requirements.

The National Association of Insurance Commissioners revised the Accounting Practices and Procedures Manual in a process referred to as Codification. The revised manual will be effective January 1, 2001. Codification has changed certain prescribed statutory accounting practices and will result in changes to the accounting practices that the insurance subsidiaries of the Company use to prepare their statutory-basis financial statements. Management believes that the impact of Codification to the Company's insurance subsidiaries' statutory-basis capital and surplus will not be material.

Restrictions on Dividends From Subsidiaries

Dividends paid by the insurance subsidiaries to the Company are limited by state insurance regulations. The insurance regulator in the state of domicile may disapprove any dividend that, together with other dividends paid by an insurance company in the prior twelve months, exceeds the regulatory maximum as computed for the insurance company based on its statutory surplus and net income. Based upon the financial statements of the Company's insurance subsidiaries as of December 31, 2000, as filed with the insurance regulators, no dividends may be paid without prior regulatory approval prior to December 2001, at which time the aggregate amount available without regulatory approval is \$7,274,000.

9. Employee Benefit Plans

Retirement Savings Plan

The Company's employees are included in a qualified defined contribution plan (the "Retirement Savings Plan") with profit sharing and discretionary savings provisions covering all eligible salaried and hourly employees. Participant contributions up to 6% of the participant's compensation are matched 60% by the Company. Profit sharing contributions to the Retirement Savings Plan are determined annually by the Company. Participants vest in Company contributions in three years. The Company recognized expense associated with the Retirement Savings Plan of \$1,944,000, \$1,610,000 and \$1,449,000 in 2000, 1999 and 1998, respectively.

Nonqualified Executive Retirement Plan

During 2000, the Company adopted a nonqualified executive retirement plan (the "Nonqualified Plan") to provide key management with the opportunity to accumulate deferred compensation which cannot be accumulated under the Retirement Savings Plan due to compensation limitations imposed by the Internal Revenue Service. The Nonqualified Plan is funded through a rabbi trust and has contribution and investment options similar to those of the Retirement Savings Plan. The Company recognized expense associated with the Nonqualified Plan of \$77,000 during 2000.

Stock Based Compensation Plans

The Company has a stock-based compensation plan, the Equity Incentive Plan (the "Plan"), for the benefit of eligible employees and directors of the Company. The Plan permits the grant of nonqualified stock options ("NQSO"), incentive stock options, stock appreciation rights, restricted stock awards and performance awards. Persons eligible to participate in the Plan include all full-time active employees and outside directors of the board of directors. The Plan allows for the granting of up to 4,000,000 shares of which 282,690 shares are available for grant as of December 31, 2000. No benefits other than NQSOs have been granted under the plan.

The terms of incentive stock options and nonqualified stock options granted under the Plan cannot exceed more than 10 and 12 years, respectively, and the option exercise price generally cannot be less than the fair market value of the Company's common stock on the date of grant. Incentive stock options and NQSOs are not exercisable in any event prior to six months following the grant date.

Stock appreciation rights generally have a grant price at least equal to 100% of the fair market value of the Company's common stock. The term of the stock appreciation rights cannot exceed 12 years. Stock appreciation rights are not exercisable prior to six months following the grant date.

Restricted stock generally may not be sold or otherwise transferred for certain periods based on the passage of time, the achievement of performance goals or the occurrence of other events. However, participants may exercise full voting rights and are entitled to receive all dividends and other distributions with respect to restricted stock. Restricted stock does not vest prior to six months following the date of grant.

On November 17, 1998, the Company and a key executive entered into a deferred stock agreement. Under the agreement the Company has an obligation to issue 73,506 shares of AMSC common stock provided the executive remains continuously employed with AMSC through November 17, 2002. The Company incurred expense of \$225,000 in 2000 and 1999 and \$28,000 in 1998 related to this agreement.

The Company also has a Director Stock Option Plan which permits the grant of NQSOs. The plan allows for the granting of up to 75,000 shares of which 14,000 shares are available for grant, as of December 31, 2000.

Effective January 1, 2000, the Company adopted a deferred compensation plan for the benefit of certain outside directors of the Company who wish to defer the receipt of eligible compensation which they may otherwise be entitled to receive from the Company. Directors who choose to participate in the plan may elect to have their deferred compensation credited to, in whole or in part, either an interest account or a Company stock unit account.

Stock option activity for all plans is as follows:

	2000	December 31, 1999	1998
Total number of NQSOs			
Outstanding at beginning of year	2,809,143	2,918,893	2,217,307
Granted	715,000	999,000	874,560
Exercised	-	-	(114,028)
Forfeited	(64,013)	(1,108,750)	(20,000)
Spin-off related:			
Conversion to UWS options ^(a)	-	-	(351,322)
AMSG modification ^(b)	-	-	312,376
Outstanding at end of year	3,460,130	2,809,143	2,918,893
Exercisable at end of year	1,807,963	1,504,976	2,365,893
Available for grant at end of year	296,690	947,677	837,927
Weighted average exercise price of NQSOs			
Outstanding at beginning of year	\$11.10	\$15.18	\$27.02
Granted - Exercise price equals market price on grant date	5.28	7.33	10.75
Granted - Exercise price is less than market price on grant date	-	-	-
Granted - Exercise price exceeds market price on grant date	-	-	12.00
Exercised	-	-	4.15
Forfeited	13.14	18.45	18.44
Outstanding at end of year	9.86	11.10	15.18
Exercisable at end of year	12.60	13.68	16.23
NQSOs by exercise price range			
Range of exercise prices	\$ 3.01 - \$8.88	\$ 3.01 - \$8.88	\$3.01
Weighted average exercise price	\$5.71	\$6.07	\$3.01
Weighted average remaining contractual life (years)	11.03	11.34	3.93
Exercisable at end of year	260,877	47,960	47,960
Outstanding at end of year	1,571,960	856,960	47,960
Weighted average exercise price of options exercisable at end of year	\$5.64	\$3.01	\$3.01
Range of exercise prices	\$10.25 - \$14.38	\$10.25 - \$14.38	\$10.25 - \$14.38
Weighted average exercise price	\$11.54	\$11.53	\$11.38
Weighted average remaining contractual life (years)	8.75	9.79	10.62
Exercisable at end of year	848,151	734,848	595,765
Outstanding at end of year	1,189,234	1,230,015	1,148,765
Weighted average exercise price of options exercisable at end of year	\$11.66	\$11.76	\$12.01
Range of exercise prices	\$15.76 - \$22.74	\$15.76 - \$22.74	\$15.76 - \$22.74
Weighted average exercise price	\$16.33	\$16.33	\$18.06
Weighted average remaining contractual life (years)	7.48	8.50	5.69
Exercisable at end of year	698,936	722,168	1,722,168
Outstanding at end of year	698,936	722,168	1,722,168
Weighted average exercise price of options exercisable at end of year	\$16.33	\$16.33	\$18.06

(a) Effective on the date of Distribution, certain AMSG stock options held by Newco/UWS employees were converted to Newco/UWS stock options.

(b) Immediately following the Distribution, the number of options was increased and exercise prices were decreased (the "modification") to preserve the economic value of those options that existed just prior to the Distribution for the holders of certain AMSG stock options.

The Black-Scholes option valuation model is commonly used in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Since the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The Company follows Accounting Principles Board Opinion No. 25 under which no compensation expense is recorded when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant. The Company's pro forma information regarding net income and net income per share has been determined as if these options had been accounted for since January 1, 1995, in accordance with the fair value method of Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock-Based Compensation".

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information is as follows:

	Year ended December 31,		
	2000	1999	1998
	<i>(In thousands, except per share data)</i>		
Pro forma net income (loss)	\$ 1,736	\$ (26,429)	\$ 6,484
Pro forma earnings (loss) per common share:			
Basic	\$ 0.12	\$ (1.60)	\$ 0.39
Diluted	\$ 0.12	\$ (1.60)	\$ 0.39

The pro forma disclosures only include the effect of options granted subsequent to January 1, 1995. Accordingly, the effects of applying the SFAS No. 123 pro forma disclosures to future periods may not be indicative of future effects.

In determining compensation cost pursuant to SFAS No. 123, the fair value for these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	Year ended December 31,		
	2000	1999	1998
Expected life of options	6.00 years	6.00 years	3.55 years
Risk-free interest rate	5.73%	6.13%	4.53%
Expected dividend yield	0.00%	0.00%	0.00%
Expected volatility factor	56%	45%	39%
Grant date fair value of options:			
Exercise price equals market price	\$ 3.09	\$ 3.84	\$ 4.83
Exercise price is less than market price	\$ -	\$ -	\$ 7.37
Exercise price exceeds market price	\$ -	\$ -	\$ 1.77



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United Wisconsin Services, Inc.

Financial Review

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Consolidated Balance Sheets

(in thousands) December 31

	2000	1999
Assets		
Current assets		
Cash and cash equivalents		
Investments - available-for-sale, at fair value	\$ 49,625	\$ 16,254
Due from affiliates	117,893	120,721
Premium receivables	5,867	1,575
Due from clinics and providers	39,091	24,215
Other receivables	10,756	19,448
Prepaid expenses and other current assets	21,093	26,337
Total current assets	22,630	29,438
	266,955	237,988
Noncurrent assets		
Investments - held-to-maturity, at amortized cost		
Property and equipment, net	9,758	9,153
Goodwill	12,969	9,938
Prepaid pension	22,178	10,492
Deferred income taxes	8,305	7,451
Other noncurrent assets	26,276	10,060
Total assets	19,385	12,072
	\$365,826	\$297,154
Liabilities and shareholders' equity		
Current liabilities		
Medical and other benefits payable		
Advance premiums	\$119,017	\$ 74,238
Due to affiliates - other	51,523	36,248
Payables and accrued expenses	12,701	13,037
Short-term debt	16,238	15,033
Other liabilities	13,823	11,890
Total current liabilities	17,418	10,274
	230,720	160,720
Noncurrent liabilities		
Note payable to affiliate		
Other benefits payable	70,000	70,000
Other liabilities	35,369	24,104
Total liabilities	12,964	11,298
	349,053	266,122
Shareholders' equity		
Preferred stock (no par value, 1,000,000 shares authorized)		
Common stock (no par value, no stated value, 50,000,000 shares authorized, 17,048,908 and 16,939,682 shares issued and outstanding at December 31, 2000 and December 31, 1999, respectively)		
Retained earnings	14,445	14,052
Accumulated other comprehensive loss	3,040	20,242
Total shareholders' equity	(712)	(3,262)
Total liabilities and shareholders' equity	16,773	31,032
	\$365,826	\$297,154

See accompanying notes.

Consolidated Statements of Operations

(In thousands) Year Ended December 31,

	2000	1999	1998
Revenues			
Health services revenues:			
Premium	\$760,624	\$651,567	\$608,917
Other	45,496	41,586	29,728
Investment results	8,254	11,371	19,029
Total revenues	814,374	704,524	657,674
Expenses			
Medical and other benefits	700,094	621,916	519,636
Selling, general and administrative	80,643	73,507	65,376
Other operating	52,377	53,897	38,141
Profit (loss) sharing on provider arrangements	460	(4,096)	2,762
Interest	6,500	5,293	1,464
Amortization of goodwill	1,065	796	450
Total expenses	841,139	751,313	627,829
Net operating income (loss)	(26,765)	(46,789)	29,845
Equity in net loss of affiliate, net of tax	(312)	-	-
Income (loss) before income tax	(27,077)	(46,789)	29,845
Income tax expense (benefit)	(10,649)	(17,785)	11,767
Net income (loss)	\$ (16,428)	\$ (29,004)	\$ 18,078
Loss per common share			
Basic	\$ (0.97)	\$ (1.72)	\$ -
Diluted	\$ (0.97)	\$ (1.72)	\$ -

See accompanying notes.

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income (Loss)

<i>(in thousands, except share data)</i>	Common Shares Outstanding	Common Stock	Retained Earnings	Investments by and Advances from AMSG	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at December 31, 1997	—	\$ —	\$ —	\$120,405	\$ 3,211	\$123,616
Comprehensive income:						
Net income	—	—	3,572	14,506	—	18,078
Change in unrealized gains/losses on investments	—	—	—	—	(2,218)	(2,218)
Comprehensive income						15,860
Cash dividends paid on common stock	—	—	(839)	—	—	(839)
Change in investment by and advances from AMSG	—	—	—	(76,133)	—	(76,133)
Distribution of equity to the Company from AMSG	—	11,423	47,355	(58,778)	—	—
Issuance of common stock in connection with the Spin-off	16,573,202	—	—	—	—	—
Issuance of common stock – other	238,879	1,955	—	—	—	1,955
Balance at December 31, 1998	16,812,081	13,378	50,088	—	993	64,459
Comprehensive loss:						
Net loss	—	—	(29,004)	—	—	(29,004)
Change in unrealized gains/losses on investments	—	—	—	—	(4,255)	(4,255)
Comprehensive loss						(33,259)
Cash dividends paid on common stock	—	—	(842)	—	—	(842)
Issuance of common stock – other	127,601	674	—	—	—	674
Balance at December 31, 1999	16,939,682	14,052	20,242	—	(3,262)	31,032
Comprehensive loss:						
Net loss	—	—	(16,428)	—	—	(16,428)
Change in unrealized gains/losses on investments	—	—	—	—	2,550	2,550
Comprehensive loss						(13,878)
Cash dividends paid on common stock	—	—	(847)	—	—	(847)
Change in ownership of affiliates	—	—	73	—	—	73
Issuance of common stock – other	109,226	393	—	—	—	393
Balance at December 31, 2000	17,048,908	\$14,445	\$ 3,040	\$ —	\$ (712)	\$ 16,773

See accompanying notes.

Consolidated Statements of Cash Flows

(In thousands) Year Ended December 31,

	2000	1999	
Operating activities	\$(16,428)	\$ (29,004)	\$ 18,071
Net income (loss)			
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	4,203	3,585	3,191
Equity in loss of affiliate	312	-	-
Realized investment losses (gains)	925	(2,145)	(9,121)
Deferred income tax (asset) liability	(10,875)	(12,383)	83
Changes in other operating accounts net of acquisitions:			
Premium receivables	(9,795)	(4,078)	(1,221)
Other receivables	5,656	(1,556)	(901)
Due from clinics and providers	9,780	(427)	(8,121)
Medical and other benefits payable	31,864	8,308	8,391
Advance premiums	15,255	5,664	6,521
Due to/from affiliates	(4,628)	4,516	3,391
Current taxes, net	10,467	(9,395)	2,111
Other, net	(7,635)	(8,323)	(1,281)
Net cash provided by (used in) operating activities	29,101	(45,238)	21,851
Investing activities			
Acquisition of new businesses net assets (net of cash and cash equivalents acquired)	(464)	(3,605)	(1,181)
Purchases of available-for-sale investments	(28,919)	(119,594)	(241,601)
Proceeds from sale of available-for-sale investments	31,466	143,761	233,971
Proceeds from maturity of available-for-sale investments	3,260	8,650	6,501
Purchases of held-to-maturity investments	(2,938)	(1,460)	(311)
Proceeds from maturity of held-to-maturity investments	2,325	-	401
Dividend from affiliate	1,572	-	-
Additions to property and equipment	(3,467)	(3,140)	(3,561)
Net cash provided by (used in) investing activities	2,835	24,612	(5,841)
Financing activities			
Cash dividends paid	(847)	(842)	(831)
Issuance of common stock	393	394	311
Decrease in investments by and advances from AMSC	-	-	(6,131)
Net borrowings on short-term debt	1,889	10,943	-
Net cash provided by (used in) financing activities	1,435	10,495	(6,651)
Cash and cash equivalents:			
Increase (decrease) during year	33,371	(10,131)	9,351
Balance at beginning of year	16,254	26,385	17,031
Balance at end of year	\$ 49,625	\$ 16,254	\$ 26,381

See accompanying notes.

Notes to Consolidated Financial Statements

1 Organization and Significant Accounting Policies

Organization

United Wisconsin Services, Inc. (the "Company") is a leading provider of managed health care services and employee benefit products. The Company's two primary product lines are (i) health maintenance organization ("HMO") products, sold primarily in Wisconsin, and (ii) specialty managed care products and services, including dental, life, disability and worker's compensation products, managed care consulting, electronic claim submission, pharmaceutical management, managed behavioral health services, case management and receivables management, sold throughout the United States.

On May 27, 1998, the Board of Directors of American Medical Security Group, Inc. ("AMSG") (formerly United Wisconsin Services, Inc.) approved a formal plan to spin off its managed care companies and specialty business to its shareholders. The Spin-off involved the creation of a new corporation originally named Newco/UWS, Inc., subsequently renamed United Wisconsin Services, Inc. ("UWS"). The Spin-off resulted in the distribution of one share of common stock of UWS on September 25, 1998 ("Spin-off date") for each share of AMSG common stock held as of September 11, 1998. AMSG received a private letter ruling from the Internal Revenue Service that the Spin-off is tax free to AMSG, UWS and their shareholders. A further description of the Spin-off and certain transactions with AMSG is included in Notes 1, 6, 7 and 10.

At December 31, 2000, Blue Cross & Blue Shield United of Wisconsin ("BCBSUW") owned approximately 46.6% of the Company's common stock. In addition, the Company is affiliated with BCBSUW through certain common officers and directors. On August 17, 1999, BCBSUW completed a purchase of 1,400,000 shares of the Company's common stock in the open market in connection with a previously disclosed plan for BCBSUW to increase its ownership in the Company. The ownership by BCBSUW, in combination with the ownership by the Company's employee benefit plans enables Compcare Health Services Insurance Corporation ("Compcare"), a wholly owned subsidiary of the Company, to use the Blue Cross and Blue Shield brand on its products.

Pending Transaction

BCBSUW's Board of Directors announced in June of 1999 its intention to convert BCBSUW from a service insurance corporation to a stockholder owned corporation. On March 28, 2000 the Wisconsin Commissioner of Insurance issued an order that allows BCBSUW to convert to a stock form of ownership by completing a combination with the Company.

In the fourth quarter of 2000, the Company announced that it had executed a definitive agreement to combine with BCBSUW. Under the agreement, BCBSUW will become a wholly owned subsidiary of the Company, and the Wisconsin United for Health Foundation, Inc. ("the Foundation") will receive 31,313,390 newly-issued shares of UWS stock. The Foundation was established for the sole purpose of benefiting public health in Wisconsin through the Medical College of Wisconsin and the University of Wisconsin Medical School.

The agreement is subject to approval by the Wisconsin Office of the Commissioner of Insurance and other regulatory approvals as well as by the shareholders of the Company.

Basis of Presentation

The consolidated financial statements present the Company's financial position, operations and cash flows as if the Company had been an independent, public company for all years presented. The Company consolidates majority-owned subsidiaries that are controlled by the Company. All intercompany transactions have been eliminated. The Company consolidates subsidiaries for which repurchase options exist (see Note 2) when control is deemed to be other than temporary. Management believes that control of Unity Health Plans Insurance Corporation ("Unity") and Valley Health Plan, Inc. ("Valley") is not temporary because exercise of the repurchase options is not probable. Any repurchase would not provide a substantial economic benefit to the option holders and would require regulatory approval pursuant to change of control regulations.

Cash and Cash Equivalents

Cash and cash equivalents include operating cash and short-term investments with original maturities of three months or less. These amounts are recorded at cost, which approximates fair value.

Investments

Investments are classified as either held-to-maturity or available-for-sale. Investments, which the Company has the intent and ability to hold to maturity, are designated as held-to-maturity and are stated at amortized cost. All other investments are classified as available-for-sale and are stated at fair value based on quoted market prices, with unrealized gains and losses excluded from earnings and reported as a component of accumulated other comprehensive income (loss), net of income tax effects. Realized gains and losses from the sale of available-for-sale debt and equity securities are calculated using the first-in, first-out basis.

Notes to Consolidated Financial Statements

Premium Receivables

Premium receivables are stated at net realizable value, net of allowances for uncollectible amounts of \$3,262,000 and \$2,858,000 at December 31, 2000 and 1999, respectively, based upon historical collection trends and management's best estimate of the ultimate collectibility.

Due from Clinics and Providers

Amounts due from clinics and providers are stated at net realizable value, net of an allowance for uncollectible amount of \$8,063,000 and \$9,548,000 at December 31, 2000 and 1999, respectively, based upon management's best estimate of the ultimate collectibility.

Other Receivables

Other receivables are stated at net realizable value, net of allowances for uncollectible amounts of \$678,000 and \$965,000 at December 31, 2000 and 1999, respectively, based upon historical collection trends and management's best estimate of the ultimate collectibility.

Property and Equipment

Property and equipment are recorded at cost. Depreciation and amortization are provided using the straight-line method over the estimated useful lives of the related assets, which range from 3 to 5 years for computer equipment and software, 3 to 10 years for furniture and other equipment, 20 to 30 years for land improvements and 10 to 40 years for buildings and building improvements.

Goodwill

Goodwill represents the excess of cost over the fair value of net assets acquired. Goodwill is being amortized on a straight-line basis over a weighted average period of approximately 17 years. Accumulated amortization was \$3,304,000 and \$2,239,000 at December 31, 2000 and 1999, respectively.

The Company periodically evaluates whether events and circumstances have occurred which may affect the estimated useful life or the recoverability of the remaining balance of goodwill. At December 31, 2000, the Company's management believed that no material impairment of goodwill existed.

Revenue Recognition

Health services premiums and managed behavioral health fees are recognized as revenue in the period in which enrollees are entitled to care. Managed care consulting revenues are generally recognized when services are rendered. Case management revenues are recognized when services are billed. Receivables management revenues are recognized when cash is received, which is in accordance with generally accepted accounting principles for the industry.

Medical and Other Benefits

Medical and other benefits expense consists principally of capitation expenses, health and disability benefit claims and life insurance benefits. In addition to actual paid claims and capitation, medical and other benefits expense includes the change in estimates for reported and unreported claims and accrued capitation fees and adjustments, which are unpaid as of the balance sheet date. The estimates for reported and unreported claims and accrued capitation fees and adjustments, which are unpaid as of the balance sheet date, are based on historical payment patterns using standard actuarial techniques. Processing costs are accrued as operating expenses based on an estimate of the costs necessary to process these claims.

The Company's year-end claim liabilities are substantially satisfied through claim payments in the subsequent year. Any adjustments to prior period estimates are reflected in the current period. Capitation represents fixed payments on a per member per month basis to participating physicians, other medical specialists and hospital systems as compensation for providing comprehensive health or dental care services. In addition, certain subsidiaries have risk-sharing, stop-loss, and bonus arrangements with certain providers. Estimated settlements relating to these arrangements are developed based on historical payment patterns using standard actuarial techniques. The portion of other benefits payable pertaining to long-term disability, worker's compensation and certain life insurance products, which is estimated to be paid more than one year from the balance sheet date, is included in noncurrent liabilities on the accompanying balance sheets.

Premium Deficiency Reserves

Premium deficiency reserves are recognized when it is probable that the future costs associated with a group of existing contracts will exceed the anticipated future premiums on those contracts.

The Company calculates expected premium deficiency reserves based on budgeted revenues and expenses, excluding investment income. Premium deficiency reserves are evaluated quarterly for adequacy.

Reinsurance

Certain premiums and benefits are assumed from and ceded to other insurance companies under various reinsurance agreements. The ceded reinsurance agreements provide the Company with increased capacity to write larger risks and maintain its exposure to loss within its capital resources. The ceding company is contingently liable on reinsurance ceded in the event that the reinsurers do not meet their contractual obligations.

Amounts assumed from and ceded to other insurance companies are summarized as follows:

<i>(In thousands)</i>			
<i>Year Ended December 31,</i>	2000	1999	1998
Reinsurance assumed			
Insurance premiums	\$29,585	\$28,895	\$28,682
Medical and other benefits	24,046	21,576	22,694
Reinsurance ceded			
Insurance premiums	\$26,103	\$29,905	\$45,755
Medical and other benefits	22,276	25,507	35,038

Reinsurance contracts are accounted for in a manner consistent with the underlying business.

The Company has reinsurance recoverable amounts outstanding of \$21,299,000 and \$18,356,000 as of December 31, 2000 and 1999, respectively. These balances are included in other current and other noncurrent assets based on the expected settlements.

Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial statement purposes and the amounts used for income tax purposes.

Earnings Per Common Share (Unaudited)

When the Company reports a net loss, stock options are not included in the calculation of earnings per share ("EPS") because their inclusion would have an antidilutive effect. Weighted average shares outstanding were 16,941,174 and 16,840,672 for the years ended December 31, 2000 and 1999, respectively.

Historical EPS has been omitted for 1998 on the Consolidated Statements of Operations because the Company was not a separate entity with its own capital structure.

Pro forma net income per common share is calculated as if the Spin-off had occurred at the beginning of fiscal year 1998, and is adjusted for additional interest expense, net of related income tax. Pro forma EPS is based on the pro forma weighted average number of shares of outstanding Company common stock, giving effect to the distribution of one share of Company stock for each share of AMSC common stock. Pro forma dilutive common equivalent shares are stated at the historical AMSC dilutive common equivalent share level.

The following table sets forth the pro forma computation of basic and diluted EPS for the year ended December 31, 1998:

	1998
Net income as reported	\$18,078,000
Pro forma adjustment - interest expense, net of tax	2,215,000
Pro forma net income	\$15,863,000
Pro forma basic weighted average common shares	16,560,382
Pro forma dilutive weighted average common shares ¹	16,563,165
EPS on net income as reported - basic and diluted ²	\$1.09
EPS on pro forma net income - basic and diluted ³	\$0.96

¹ Pro forma calculations for dilutive securities through September 25, 1998, assume that the price of the stock and the strike price of the options is the same for the periods prior to the Spin-off date.

² EPS on net income, as reported, are computed by dividing net income, as reported, by the pro forma weighted average number of common shares outstanding.

³ EPS on pro forma net income are computed by dividing pro forma net income by the pro forma weighted average number of common shares outstanding.

Use of Estimates

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Reclassifications

Certain reclassifications have been made to the consolidated financial statements for 1999 and 1998 to conform with the 2000 presentation.

9 Shareholders' Equity

Statutory Financial Information

Insurance companies are subject to regulation by the Office of the Commissioner of Insurance ("OCI") of the State of Wisconsin and certain other state insurance regulators. These regulations require, among other matters, the filing of financial statements prepared in accordance with statutory accounting practices prescribed or permitted for insurance companies. The statutory surplus of insurance subsidiaries at December 31, 2000 and 1999 aggregated \$67,072,000 and \$76,958,000, respectively. The statutory net income (loss) of insurance subsidiaries aggregated \$(12,357,000), \$(25,512,000) and \$15,884,000 in 2000, 1999 and 1998, respectively.

During 1998, the National Association of Insurance Commissioners ("NAIC") adopted Codification of Statutory Accounting Principles ("Codification") which provides interpretive guidance on statutory accounting principles and will replace the current manual of Accounting Practices and Procedures adopted by the NAIC commissioners. In addition, the NAIC is now considering amendments to Codification that would be effective retroactively on the recommended implementation date of January 1, 2001. Such amendments could have a significant impact on Codification guidelines. Codification provides new interpretive guidance for existing statutory accounting principles. Management believes Codification will have a significant negative impact on the statutory surplus of certain of the insurance subsidiaries of UWS. Depending on the final resolution of pending amendments to Codification and collection of provider receivables, UWS may be required to obtain additional capital or implement other measures, such as securing new reinsurance treaties, to mitigate the impact of Codification on surplus.

State insurance regulations also require the maintenance of a minimum compulsory surplus based on a percentage of premiums written. As of December 31, 2000, statutory compulsory excess surplus and regulatory minimum compulsory surplus, as calculated and permitted by OCI, were \$25,685,000 and \$31,181,000, respectively. In addition, the Company's insurance subsidiaries are subject to risk-based capital ("RBC") requirements promulgated by the NAIC. The RBC requirements establish minimum levels of capital and surplus based upon the insurer's operations. The Company intends to make capital contributions on an ongoing basis or take other steps necessary to satisfy all promulgated capital and surplus requirements. In addition, Compcare is required to maintain certain

capital and liquidity levels in conjunction with the licensing of certain products by the Blue Cross Association ("BCA"). While exceeding the minimum standards to maintain its license, Compcare is subject to ongoing monitoring by the BCA.

Restrictions on Dividends From Subsidiaries

Dividends paid by insurance subsidiaries are limited by state insurance regulations. The insurance regulator in the state of domicile may disapprove any dividend which, together with other dividends paid by an insurance company in the prior twelve months, exceeds the regulatory maximum as computed for the insurance company based on its statutory surplus and net income. As of December 31, 2000, the Company's insurance subsidiaries are unable to pay dividends to the Company in 2001 without regulatory approval.

10 Employee Benefit Plans

Pension and Postretirement Benefits

The Company and certain of its subsidiaries participate with BCBSUW in a multiple employer defined benefit pension plan ("the Plan"). The Plan provides retirement benefits to covered employees based primarily on compensation and years of service. Since the Plan is overfunded, no contributions were made in 2000, 1999 or 1998.

Prior to December 31, 1998, separate salaried and hourly pension plans existed. These plans were merged into a single plan in an effort to reduce administrative expenses and streamline communication with plan participants. The merger had no material effect on pension assets, liabilities or funding levels.

The Company has postretirement benefit plans to provide certain medical, dental, and vision benefits and life insurance for certain groups of retired employees. Such plans were amended in 1997 to limit the Company's financial contribution in future periods. No benefits will be provided for individuals hired after the effective dates of these amendments.

Notes to Consolidated Financial Statements

The following table summarizes the change in the pension and postretirement benefit obligations as of December 31, 2000 and 1999:

(In thousands)	Pension		Postretirement	
	2000	1999	2000	1999
Accumulated benefit obligation at beginning of year	\$20,377	\$20,876	\$3,122	\$3,069
Service cost	1,854	1,765	183	210
Interest cost	1,356	1,342	217	213
Plan amendments	-	-	-	(101)
Actuarial (gains) losses	373	(1,579)	1	(215)
Company transfers	821	(890)	-	-
Benefits paid	(1,742)	(1,137)	(46)	(54)
Accumulated benefit obligation at end of year	\$23,039	\$20,377	\$3,477	\$3,122

The pension and postretirement plans' assets are comprised primarily of debt, equity and other marketable securities, including 700,000 shares of UWS stock with a fair value of \$2,363,000 at December 31, 2000. The plan received dividends on UWS stock

in the amount of \$35,000 during 2000. The following table summarizes the change in the pension and postretirement plan assets as of December 31, 2000 and 1999:

(In thousands)	Pension		Postretirement	
	2000	1999	2000	1999
Fair value of plan assets at beginning of year	\$37,332	\$33,988	\$ -	\$ -
Employer contributions	-	-	46	54
Actual return on plan assets	4,800	5,371	-	-
Company transfers	821	(890)	-	-
Benefits paid	(1,742)	(1,137)	(46)	(54)
Fair value of plan assets at end of year	\$41,211	\$37,332	\$ -	\$ -

The following table provides a reconciliation of the funded status of the plans to the prepaid pension and (accrued) postretirement costs at December 31, 2000 and 1999:

(In thousands)	Pension		Postretirement	
	2000	1999	2000	1999
Funded status of plan at end of year	\$18,172	\$16,955	\$(3,477)	\$(3,122)
Unrecognized net transition asset	(295)	(531)	-	-
Unrecognized prior service cost	(4,077)	(4,766)	(966)	(1,063)
Unrecognized gain	(5,495)	(4,207)	(237)	(259)
Prepaid (accrued) at end of year	\$ 8,305	\$ 7,451	\$(4,680)	\$(4,444)

Weighted-average assumptions used as of September 30, 2000, the measurement date, in developing the projected benefit obligations are as follows:

	Pension		Postretirement	
	2000	1999	2000	1999
Discount rate	7.00%	7.00%	7.00%	7.00%
Rate of compensation increase	4.75	4.75	N/A	N/A
Health care cost trend rate	N/A	N/A	5.00	5.00
Expected rate of return on plan assets	9.25	9.00	N/A	N/A

The unrecognized net asset is being amortized over the remaining estimated service lives of participating employees at January 1, 1986: 15.4 years for salaried employees and 16.9 years for hourly employees.

The effect of a 1% increase or decrease in the medical trend rate would be an approximate increase or decrease of \$75,000 in the benefit obligation as of September 30, 2000.

The components of the pension credit and postretirement benefit cost, which are included in selling, general and administrative expenses, for the years ended December 31, 2000, 1999 and 1998 are as follows:

(In thousands)	Pension			Postretirement		
	2000	1999	1998	2000	1999	1998
Service cost	\$ 1,854	\$ 1,765	\$ 1,849	\$ 183	\$ 210	\$ 182
Interest cost	1,356	1,342	1,362	217	213	186
Expected return on plan assets,	(3,139)	(2,919)	(2,791)	-	-	-
Net amortization of transition asset	(236)	(245)	(274)	-	-	-
Amortization of prior service cost	(689)	(690)	(690)	(97)	(90)	(90)
Amortization of unrecognized (gain) loss	-	7	-	(11)	(10)	(14)
Pension (credit) and postretirement benefit costs for the year	\$ (854)	\$ (740)	\$ (544)	\$ 292	\$ 323	\$ 264

After giving effect to all administrative expense allocations between the Company and BCBSUW, the pension credit was \$1,247,000, \$1,127,000 and \$622,000 in 2000, 1999 and 1998, respectively.

Defined Contribution and Bonus Plans

The Company and certain of its subsidiaries participate in defined contribution plans whereby the employer contributes a percentage of participants' qualifying compensation up to certain limits, as defined by the plans. The Company and certain of its subsidiaries also participate with BCBSUW in various other profit sharing and bonus programs. Expenses related to all of these plans, after giving effect to all administrative expense allocations between the Company and BCBSUW, totaled \$1,281,000, \$1,356,000 and \$2,475,000 in 2000, 1999 and 1998, respectively.

Stock-Based Compensation Plans

The Company has a stock-based compensation plan covering employees and directors that allows for option grants of up to 4,500,000 shares of common stock as incentive or nonqualified stock options ("NQSOs").

At the Spin-off date, certain of the options to purchase AMSG common stock held by the Company's employees were converted to Company stock options. AMSG options totaling 2,232,334 were converted into an equal amount of Company and AMSG options, including 1,000,000 options related to an acquisition. The options were converted at exercise prices that maintained the amount of unrealized stock appreciation that existed immediately prior to the Spin-off date. The vesting dates and expiration periods of the options were not affected by the conversion.

In 1992, certain executive officers of AMSG were awarded stock appreciation rights ("SARs") in AMSG. At the Spin-off date, 67,500 AMSG SARs were converted into SARs of the Company to provide equivalent value.

Notes to Consolidated Financial Statements

The Company follows Accounting Principles Board Opinion No. 25 under which no compensation expense is recorded when the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant. The Company's pro forma information, as if the options granted subsequent to the Spin-off date had been expensed in accordance with SFAS 123, "Accounting for Stock-Based Compensation", is as follows:

(in thousands, except per share data)
Year Ended December 31,

	2000	1999	1998
Pro forma net income (loss)	\$(17,181)	\$(29,418)	\$18,021
Pro forma earnings (loss) per common share:			
Basic	\$ (1.01)	\$ (1.75)	\$ 1.09
Diluted	\$ (1.01)	\$ (1.75)	\$ 1.09
Assumptions:			
Risk-free interest rate	6.57%	5.33%	4.62%
Dividend yield	1.13%	0.57%	0.70%
Volatility factor	0.60	0.45	0.45
Weighted average expected life	6 years	6 years	6 years

As calculated using the Black-Scholes model, the weighted average, grant-date fair value of options granted in which the exercise price equaled the market price on the date of the grant was \$2.54, \$4.27 and \$3.34 per share for 2000, 1999 and 1998, respectively.

Stock option activity for all plans is as follows:

Year Ended December 31,	2000	1999	1998
Total number of NQSOs			
Outstanding at beginning of year	2,705,687	2,689,034	-
Conversion of AMSG options	-	-	2,232,354
Granted	1,055,800	475,700	456,700
Exercised	-	-	-
Forfeited	(127,891)	(459,047)	-
Outstanding at end of year	3,633,596	2,705,687	2,689,034
Exercisable at end of year	2,119,210	1,877,109	1,640,637
Available for grant at end of year	866,404	1,794,313	1,935,966
Weighted average exercise price of NQSOs			
Outstanding at beginning of year	\$11.21	\$11.58	-
Conversion of AMSG options - range of exercise prices	-	-	\$9.61-16.81
Granted-Exercise price equals market price on grant date	\$ 4.45	\$ 8.85	\$ 7.19
Exercised	-	-	-
Forfeited	\$ 9.85	\$10.61	-
Outstanding at end of year	\$ 9.39	\$11.21	\$11.58
Exercisable at end of year	\$11.82	\$12.17	\$11.61

Year Ended December 31,

2000

NQSOs by exercise price range

Exercise price	\$ 4.31-\$ 5.19
Weighted average exercise price	\$ 4.33
Weighted average remaining contractual life	11.03
Outstanding at end of year	882,300
Exercisable at end of year	-
Weighted average exercise price of options exercisable at end of year	N/A
Exercise price	\$ 5.50-\$ 6.00
Weighted average exercise price	\$ 5.54
Weighted average remaining contractual life	11.29
Outstanding at end of year	106,000
Exercisable at end of year	-
Weighted average exercise price of options exercisable at end of year	N/A
Exercise price	\$ 7.19
Weighted average exercise price	\$ 7.19
Weighted average remaining contractual life	9.75
Outstanding at end of year	385,100
Exercisable at end of year	212,450
Weighted average exercise price of options exercisable at end of year	\$ 7.19
Exercise price	\$ 8.50-\$ 9.19
Weighted average exercise price	\$ 8.53
Weighted average remaining contractual life	10.10
Outstanding at end of year	367,000
Exercisable at end of year	128,575
Weighted average exercise price of options exercisable at end of year	\$ 8.52
Exercise price	\$ 9.61-\$13.42
Weighted average exercise price	\$11.27
Weighted average remaining contractual life	7.38
Outstanding at end of year	851,700
Exercisable at end of year	742,631
Weighted average exercise price of options exercisable at end of year	\$11.22
Exercise price	\$13.53
Weighted average exercise price	\$13.53
Weighted average remaining contractual life	0.93
Outstanding and exercisable at end of year	1,000,000
Weighted average exercise price of options exercisable at end of year	\$13.53
Exercise price	\$14.04-\$16.81
Weighted average exercise price	\$15.81
Weighted average remaining contractual life	8.07
Outstanding at end of year	41,496
Exercisable at end of year	35,554
Weighted average exercise price of options exercisable at end of year	\$15.67

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Since the Company's employee

stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimates, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

11 Quarterly Financial Information (Unaudited)

Selected quarterly financial data is as follows:

(In thousands, except per share data)	Quarter				Total
	First	Second	Third	Fourth	
2000					
Total revenues					
Loss before income tax	\$205,553	\$190,715	\$197,580	\$220,526	\$814,374
Net loss	(3,914)	(2,166)	(6,797)	(14,200)	(27,077)
Loss per common share ¹ :	(2,586)	(1,208)	(3,525)	(9,129)	(16,428)
Basic	\$ (0.15)	\$ (0.07)	\$ (0.21)	\$ (0.54)	\$ (0.97)
Diluted	\$ (0.15)	\$ (0.07)	\$ (0.21)	\$ (0.54)	\$ (0.97)
1999					
Total revenues					
Income (loss) before income tax	\$173,009	\$174,943	\$175,241	\$181,331	\$704,524
Net income (loss)	4,158	(13,481)	(8,012)	(29,454)	(46,789)
Earnings (loss) per common share ¹ :	2,672	(7,985)	(4,713)	(18,978)	(29,004)
Basic	\$ 0.16	\$ (0.47)	\$ (0.28)	\$ (1.13)	\$ (1.72)
Diluted	\$ 0.16	\$ (0.47)	\$ (0.28)	\$ (1.13)	\$ (1.72)

¹ When the Company reports a net loss, potentially dilutive securities are not included in the calculation of earnings per share ("EPS") because their inclusion would have an antidilutive effect.

12 Segment Reporting

The Company has two reportable business segments: HMO products sold primarily in Wisconsin, and specialty managed care products and services, including dental, life, disability and worker's compensation products, managed care consulting, electronic claim submission, pharmaceutical management, managed behavioral health services, case management and receivables management, sold throughout the United States.

"Other Operations" includes operations not directly related to the business segments, unallocated corporate items (i.e. corporate interest expense on corporate debt, amortization of goodwill and intangibles and unallocated overhead expenses) and intercompany eliminations. The Company evaluates segment performance based on profit or loss from operations before income taxes. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

